

April 30, 2008

Ms. Naomi Richman  
Chief Credit Officer  
Global Public, Project and Infrastructure Finance  
Moody's Investors Service  
250 Greenwich Street  
New York, NY 10007

RE: Request for Comment: Assignment of Global Ratings to Tax-Exempt Municipal Obligations

Dear Ms. Richman:

On behalf of DEPFA First Albany Securities LLC ("DEPFA First Albany"), I want to thank you for initiating such an important dialogue concerning global scale ratings ("GSRs") in the municipal market. As an investment banking firm that interfaces with both municipal issuers and the buy-side, and as a major investor in public sector debt through our parent, DEPFA Bank plc, we would like to share a few observations and recommendations for your consideration in developing new municipal finance rating procedures and/or methodologies.

Clearly, tax-exempt municipal bonds historically have required higher yields (traded "cheap") on an after-tax basis compared to similarly rated taxable non-muni bonds including corporate and agency securities. There are a number of factors that promote this result including (i) a more limited universe of investors --- retail and retail proxies, insurance companies, and bond funds --- that capture value from the tax-exemption, (ii) a widely differentiated market issuer credits, and (iii) the risk of the value of the tax-exemption going forward, since tax rates may decline or alternative tax policies may be implemented, such as a flat tax, which would diminish the value of the tax-exemption. These factors will not disappear even with the implementation of global scale ratings and a more consistent rating among municipal and non-municipal debt, i.e. municipal debt receiving higher ratings than currently assigned.

Nevertheless, we believe there will be several major potential impacts from implementation of an exclusive global scale rating system on tax-exempt municipal bonds: (i) modest compression of spreads; (ii) expansion of retail investor interest; (iii) positive impact on money market eligibility of short-term instruments particularly as it relates to TOB programs, subject to SEC rulings; and (iv) increase in the number of foreign investors through global financial institutions in light of capital requirements under Basel II.

As ratings compression due to GSR implementation produces many more "Aaa" ratings, this will afford some credits that are currently rated at lower levels in the municipal ratings system to gain better pricing in the capital markets. In order to better understand the potential impact GSRs might have on tax-exempt trading values, we need to look at both tax-exempt and taxable markets. Internally, we looked at trading spreads for a few selected state GOs in 10 year terms

for both the tax-exempt and taxable markets. All bonds listed in the table below are state G.O. bonds that should qualify for a ‘Aaa’ GSR rating based on indications of preliminary mapping to the municipal rating scale.

State G.O. Issuer	Current Moody’s Rating	Tax-exempt yield spread to MMD	Taxable yield spread to 10 Year U.S. Treasury
MD	Aaa	+5	+125
NY	Aa3	+13	+130
NC	Aaa	+5	+125
IL	Aa3	+17	+135
WA	Aa1	+15	+130
<b>CA</b>	<b>A1</b>	<b>+50</b>	<b>+145</b>
CT	Aa3	+10	+130
MA	Aa2	+12	+130

This theoretical pricing matrix indicates (all things except ratings being equal) that trading spreads would tighten with the GSR in place for states with lower current municipal ratings levels. As implied in the table above, even with the impact of compression we don’t believe the market will price all comparably-rated GSR issuers the same. Or stated differently, a “Aaa” is NOT a “Aaa” is NOT a “Aaa”.

This last point above underscores the desire and need for the investor universe to evaluate the relative pricing of different issuers even if they have the same GSR. This relates back to the point that ratings (whether relative on a global scale vs. a sub-sector like the tax-exempt municipal market) are only one factor in the determination of the pricing/trading value of an issuer’s debt. For example, supply and demand of a certain issuer’s bonds are key factors in the valuation of pricing/trading value. That notwithstanding, we believe that in addition to default analysis there are other important credit variables (management, budget condition, reserves, etc) that have been typically included in Moody’s credit reports and should continue to be monitored and evaluated where relevant to the payment of debt service and informative to the prospective financial condition of an issuer.

The second major potential impact of GSRs on the tax-exempt market is the improvement in desirability of Aaa-rated credits by retail investors. This investor segment seeks the certainty of “Aaa” ratings, as demonstrated by the success of the mono-line bond insurers. Their credit wraps, in the past, had been the security blanket for these investors. We expect that once a greater share of the municipal market achieves “Aaa” ratings, all of these “Aaa” bonds will be the “comfort zone” bonds to satisfy the retail investor demand for “Aaa” investments. For example, we anticipate the creation of “Aaa” bond funds, not composed of insured paper, but instead composed of natural “Aaa” GSR-rated municipal bonds.

In addition, the importance of tender option bond programs to the municipal capital markets cannot be overstated. TOB programs have created leverage and expanded the universe of buyers

of municipal debt considerably over the past decade. With the impact of the current market disruption related to credit, we have witnessed a visceral impact on the viability of TOB programs to create leverage and investor capacity. With the establishment of an exclusive GSR system, it conceivably would be easier for such programs to function without the need for credit enhancement.

Lastly, under Basel II, Aaa-rated credits held by financial institutions will receive preferred treatment with respect to capital reserve requirements. As such, use of the GSR system creates an opportunity for foreign capital through global institutions like DEPFA Bank plc to more efficiently expand their participation in the U.S. municipal finance market.

In this context, DEPFA First Albany Securities recommends full implementation of the Global Scale as a replacement of the municipal ratings scale as it currently exists. Our rationale is based on the following factors:

1. The presence of a dual rating system penalizes many municipal issues as they are forced to pay higher interest and/or insurance premium costs. These additional expenses do not reflect actual risks incurred by the investor, as indicated by municipal default rates.
2. Due to the municipal bond industry crisis, monolines are no longer the “great equalizers.” To date, municipal issuers have been forced to fund premiums in order to receive their global rating, since financial guarantors are rated on the global scale. With the decline of the monoline industry, this option is not as viable. Furthermore, tax-exempt issuers should not have to pay for a Aaa/AAA global rating scale when in fact, most are inherently Aaa/AAA on a global scale basis and have proven to be of much stronger credit quality than the previously Aaa/AAA rated monolines.
3. Due to the U.S. Securities and Exchange Commission Rule 2a-7, tax-exempt securities should have the global rating scale to reflect the true risks and simultaneously qualify most securities. To date, because the municipal scale was applied, most issuers had to pay a premium (for insurance) in order to meet the 2a-7 requirements. As stated above, this is an unnecessary expense for the majority of issuers due to extremely low default rates.
4. A dual rating system will confuse the market. Investors will always argue for pricing based on a lower rating since they can buy bonds at higher yields. Furthermore, due to the Basel accord, many financial institutions are required to use the lower rating where two distinct ratings exist from the same rating agency.

In short, we believe that Moody’s should merge the municipal scale with the GSR methodology into one system that can serve the need for consistency broadly across asset classes with respect to default risk yet can also provide some qualitative distinctions on some key credit variables.

More explicitly, we recommend that Moody's adopt a system that uses the current Aaa/Aa/A/Baa scale for the main rating based on default risk analysis; however, the system for tracking the other qualitative credit factors would be based on a numerical ranking system that accompanies the rating. For example, if Moody's tracks five key variables each able to ascertain a "-1", "0" or "+1", the maximum modifier would be 5 and conversely the minimum would be "-5". With a ten point spread, there should be room to distinguish between issuers that employ good best practices and those who don't. Also, the positive or negative net modifier will give the market a clear sense of overall direction that is intuitive without being overly burdensome. Each credit report ostensibly would contain the default analysis for the GSR as well as the individual variable rankings on the numerical scale for the other qualitative credit factors.

We commend you on your efforts thus far and welcome the opportunity to discuss our thoughts and recommendations further with you.

Sincerely,



Samuel L. Smalls, Managing Director  
DEPFA First Albany Securities LLC